

State Retail Rate Regulation of Local **Exchange Providers as of September 2005** 1/26/17 Kate Whitney 444 3056 PSC

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EXECUTIVE SUMMARY

The year 2005 saw significant changes in the retail rate regulation of local exchange carriers (LECs) in the United States. Between October 2004 and September 2005, the period covered in this briefing paper, fourteen states adopted new state laws affecting the regulatory regimes of their local carriers; thirteen states reviewed or adopted new rate plans for one or more of their incumbents and 22 states deregulated services, particularly those provided in competitive urban areas or designated as competitive.

As in previous years, the majority of states (40) use some form of price cap regime to regulate their incumbent local exchange carriers (ILECs), with seven states using it for all their ILECs. Only five states still use rate of return (ROR) to regulate all their incumbents; increasingly states apply a mix of regimes to regulate their carriers, combining price cap regulation with ROR, rate flexibility or deregulation, especially for their smaller incumbents. Meanwhile, larger incumbents have obtained greater flexibility and rate deregulation for an increased number of services. Many states have already deregulated bundled and competitive services. Complete deregulation has so far been implemented in only three states, all within the Qwest region, but it can be expected that the trend to deregulate the rates for basic services will continue. As for the competitive local exchange carriers (CLECs), they are flexibly regulated in 27 states and their rates are not reviewed in 21 more. The remaining three states (Delaware, New Jersey, and Virginia) regulate some of the CLECs rates.

This report includes several tables that provide different levels of detail about the regulatory regimes of local exchange carriers in the United States, both incumbent and competitive. For a fast summary, refer to Table 6 at the end of the report or to the different figures, illustrating the status of rate regulation in the different states. Table 2 and Figure 4 show the changes in regulation that occurred during the period covered in this report.

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INTRODUCTION

This briefing paper shows the status of retail rate regulation of local exchange carriers in the United States as of September 2005. The information included was obtained from the Supplemental White Papers on Retail Rate Regulation of Local Exchange Providers, published each year by State Telephone Regulation Report, and from staff members of 19 states, who reviewed the information and provided revisions.

Following the trend of previous years, incumbent local exchange carriers (ILECs) continue transitioning from rate-of-return regulation (ROR) to alternative forms of regulation, including price caps, flexible regulation and particularly towards deregulation of competitive and non-basic services. Among the different regulatory regimes, price cap regulation is the most commonly adopted by the states to regulate the rates of their ILECs, particularly of the larger ones, as illustrated in Table 6 and Figure 1.

Price Cap Regulation

The summary information provided in Table 6 indicates that a total of 40 states use some form of price cap regulation. Of them, only seven states (Alabama, Delaware, District of Columbia, Louisiana, Pennsylvania, Rhode Island, and Texas) apply it to all their ILECs, including the Regional Bell Operating Companies (RBOCs) and other smaller incumbent operators. The most common trend among these 40 states is to regulate the rates of the large incumbents under a price cap plan while maintaining smaller incumbents under ROR regulation (19 states).

In many states, smaller incumbents were given the option to transition from traditional ROR regulation to price caps or some other form of alternative regulation. As a result, in some states smaller operators are under a mix of regimes, while the large incumbents remain under price cap regulation.

Although many smaller operators decided to remain under ROR, some have opted for different forms of alternative regulation, ranging from streamlined ROR with some pricing flexibility (Wisconsin) to pricing flexibility (Indiana), and from a mix of rate freeze and deregulation (Michigan) to price cap regimes or price-based regulation (North Carolina, Ohio, South Carolina, and Wisconsin).

Other states have granted rate deregulation to their smaller incumbents and cooperatives, while keeping larger incumbents under price cap regulation. Iowa, New Mexico, and Virginia, for instance, have deregulated rates for all their smaller incumbents; meanwhile Indiana, and Wyoming have done so for all their cooperatives. North Dakota and Oregon have deregulated the retail rates of smaller incumbents, but still regulate those of Qwest (price caps) and other larger incumbents (ROR).2 Other states (Arkansas, Minnesota, New York, and West Virginia) also apply different regulatory regimes to their incumbent local exchange carriers, combining price caps with ROR, price flexibility and deregulation. As of September 2005 eight states were using a combination of regimes to regulate their ILECs, as shown in Table 6.

Traditional Regulation

Despite the prevalence of price caps, traditional rate of return regulation (ROR) is still in use in 36 states, mostly to regulate smaller incumbents, as

¹ Idaho is not included within this group because it regulates Qwest, its largest ILEC, under a hybrid regime that combines price caps and deregulation. Other incumbents are under ROR.

² North Dakota deregulated the retail rates of investorowned companies with less than 8,000 lines and of all its cooperatives.